

REPORT ON EXAMINATION
OF THE
GREENWICH INSURANCE COMPANY
AS OF
DECEMBER 31, 2005

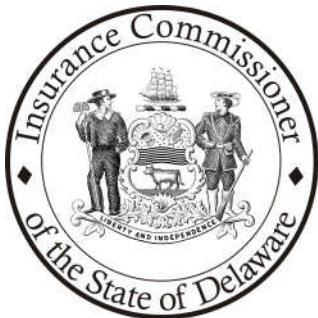
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2005 of the

GREENWICH INSURANCE COMPANY

is a true and correct copy of the document filed with this Department.

ATTEST BY: *Antoinette Handy*

DATE: 18 OCTOBER 2007



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 18TH DAY OF OCTOBER 2007.

Matthew Denn

Insurance Commissioner

REPORT ON EXAMINATION
OF THE
GREENWICH INSURANCE COMPANY
AS OF
December 31, 2005

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matt Denn", written over a horizontal line.

MATTHEW DENN
INSURANCE COMMISSIONER

DATED this 18TH Day of OCTOBER 2007.

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SALUTATION

August 13, 2007

Honorable Alfred Gross
Chairman, Financial Condition (E)
Committee, NAIC
State Corporation Commission
Bureau of Insurance
PO Box 1157
Richmond, VA 23218

Honorable Matthew Denn
Delaware Department of Insurance
841 Silver Lake Boulevard
Dover, Delaware 19904

Honorable Thomas E. Hampton
Secretary, Northeastern Zone (I), NAIC
Department of Insurance, Securities and Banking
Government of the District of Columbia
810 First Street N.E., Suite 701
Washington, DC 20002

Honorable Merle D. Scheiber
Secretary, Midwestern Zone (III), NAIC
South Dakota Division of Insurance
Department of Revenue and Regulation
445 East Capital Avenue
Pierre, SD 57501-3185

Honorable Julie Mix McPeak
Secretary, Southeastern Zone (II), NAIC
Office of Insurance
Commonwealth of Kentucky
P.O. Box 517
Frankfort, KY 40602-0517

Honorable Kent Michie
Secretary, Western Zone (IV), NAIC
Utah Department of Insurance
3110 State Office Building
Salt Lake City, Utah 84114-1201

Dear Commissioners:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority No. 06-003, dated December 15, 2005, an Association examination has been made of the affairs, financial condition and management of the

GREENWICH INSURANCE COMPANY

hereinafter referred to as the "Company" or "GIC" and incorporated under the laws of the State of Delaware as a stock company with its home office located at 1201 North Market Street, Wilmington, Delaware 19801. The examination was conducted at the main administrative office of the Company, located at 70 Seaview Avenue, Stamford, CT 06902.

The report of such examination is submitted herewith.

SCOPE OF EXAMINATION

The last examination was conducted as of December 31, 2002. This examination covers the period since that date through December 31, 2005, and consisted of a general review of the Company's business policies and practices, management, any corporate matters incident thereto, a verification and evaluation of assets and determination of liabilities. Transactions subsequent to the latter date were reviewed where deemed necessary.

The format of this report is designed to explain the procedures employed on examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible officials of the Company during the course of the examination.

The general procedures of the examination followed the rules established by the Committee on Financial Condition Examiners Handbook of the National Association of Insurance Commissioners ("NAIC") and generally accepted statutory insurance examination standards consistent with the Insurance Laws and Regulations of the State of Delaware. In accordance with the aforementioned Handbook, the consulting firm of INS Services, Inc. performed an information systems review.

In addition to items hereinafter incorporated as a part of the written report, the following areas were checked and made part of the work papers of this examination:

Statutory Deposits
Employees' Welfare
Legal Actions Pending Settlement
All Asset & Liability Items not mentioned

HISTORY

GIC, previously known as Harbor Insurance Company, is a Delaware domiciled insurer which writes property and casualty insurance on an admitted basis in fifty states, the District of Columbia, and Puerto Rico. The Company was originally incorporated under the laws of the State of California on February 18, 1946, and began business on May 4, 1946. The Company operated under the name Harbor Insurance Company until 1991, when the present title was adopted. Effective December 24, 2002, the Company was redomiciled from the State of California to the State of Delaware.

Effective December 13, 1990, all of the outstanding shares of GIC were purchased from The Continental Corporation by XL Reinsurance America Inc. (formerly known as NAC Reinsurance Corporation), a New York domiciled insurer (“XLRA”), thereby making GIC a wholly-owned direct subsidiary of XLRA. XLRA is a wholly-owned indirect subsidiary of X.L. America, Inc., a Delaware domiciled corporation (“X.L. America”), which, in turn, is an indirect wholly-owned subsidiary of XL Capital Ltd, a Cayman Islands domiciled New York Stock Exchange publicly traded company (“XL Capital”). X.L. America is the ultimate United States parent of GIC and its insurer and non-insurer affiliates, all of which are members of the XL Capital Holding Company System.

Effective June 30, 2003, with the approval of the companies’ States of domicile, the holding company structure of X.L. America was restructured. As a result of this realignment, XLRA contributed all of the issued and outstanding shares of XL Insurance America, Inc., a Delaware domiciled insurer (“XLIA”), to GIC, thereby making XLIA a wholly-owned subsidiary of GIC, and an indirect wholly-owned subsidiary of XLRA and X.L. America. As a result of the contribution of XLIA to GIC, XL Select Insurance Company, an Oklahoma domiciled insurer (“XL Select”), a wholly-owned subsidiary of XLIA, became an indirect wholly-owned subsidiary of GIC. Additionally,

effective June 30, 2003, XLRA contributed all of the issued and outstanding shares of XL Insurance Company of New York, Inc., a New York domiciled insurer (“XLNY”), to XLIA, thereby making XLNY an indirect wholly-owned subsidiary of GIC.

CAPITALIZATION

Common Capital Stock

The capital stock of the Company has not changed since the previous examination of the Company. The Company has 1,000,000 authorized shares of \$28.00 par value common capital stock of which 127,075 are issued and outstanding to its immediate parent, XLRA. The Company is also authorized to issue 5,000 shares of preferred capital stock at a par value of \$10.00. No shares of the preferred stock are issued and outstanding.

Dividends

There were no stockholder dividends paid during the examination period.

MANAGEMENT AND CONTROL

Stockholders

Under the terms of the amended bylaws, meetings of the shareholders shall be held at such time and place, either within or outside the State of Delaware, as shall be designated from time to time by the Board of Directors. The Directors and Officers were traced to the Jurat page of the December 31, 2005 Annual Statement.

Directors

Pursuant to the general corporation laws of the State of Delaware, as implemented by the Company’s Certificate of Incorporation and Bylaws, the business and affairs of the Company shall

be managed by or under the direction of the Board of Directors, which shall be determined by the shareholders.

During the period under review, the Board of Directors, as required, held annual meetings as soon as practicable after the annual shareholder's meeting, as well as quarterly meetings. Under the terms of the bylaws of the Company, as adopted by the Board, a majority of the entire Board of Directors shall constitute a quorum for the transaction of business.

Directors duly elected and serving at December 31, 2005 and their residence locations are as follows:

<u>Name</u>	<u>Address</u>	<u>Business Affiliation</u>
Richard Stephen Banas	Lexington, KY	Senior Vice President
Penny Ann Foltz	Dover, DE	Senior Vice President
Richard Harold Miller	New Fairfield, CT	Senior Vice President
Lee Larkin Bennett	Woodstock, MD	Senior Vice President
Dennis Patrick Kane	Island Heights, NJ	President
David Bruce Porteus	Portland, CT	Senior Vice President
David Brian Duclos	Exton, PA	Senior Vice President
Robert Paul Klepper	Asheville, NC	Senior Vice President
Michael Allen Zauderer	Carmel, NY	Vice President
Janet Ericson Duncan	West Hartford, CT	Senior Vice President
Kenneth Peter Meagher	Ridgefield, CT	Secretary

Officers

Under the terms of the bylaws of the Company, the officers of the Company shall be a President, a Secretary, and a Treasurer. The Board of Directors, in its discretion, may also choose

a Chairman of the Board of Directors (who must be a director) and one or more Vice Presidents, Assistant Secretaries, Assistant Treasurers and other officers. The same person may hold any number of offices, unless prohibited by law or the Certificate of Incorporation. The officers of the Company shall hold office until their successors have been elected and qualified, or until their resignation or removal from office. The senior officers elected during 2005 and serving at December 31, 2005 were as follows:

<u>Name</u>	<u>Title</u>
Dennis Patrick Kane	President
Kenneth Peter Meagher	Secretary
Gabriel George Carino III	Assistant Treasurer
Richard Stephen Banas	Senior Vice President
Christopher Frederic Buse	Senior Vice President
Gregory Alan Douglas	Senior Vice President
Janet Ericson Duncan	Senior Vice President
Robert Paul Klepper	Senior Vice President
Thomas William Muller	Senior Vice President
David Bruce Porteus	Senior Vice President
Lee Larkin Bennett	Senior Vice President
Richard Thomas Corbett Jr.	Senior Vice President
David Brian Duclos	Senior Vice President
Penny Ann Foltz	Senior Vice President
Richard Harold Miller	Senior Vice President
Robert Louis Nason	Executive Vice President

During the period under examination, specifically the period 2003 through June 2004, the Company could not produce copies of all notifications of the changes of directors or officers to the Delaware Department and as a result, was in violation of 18 Del.C. §4919 - - Notice of change of directors or principal officers.

18 Del.C.§4919 - Notice of change of directors or officers, states the following:

“Every domestic stock or mutual insurer shall promptly notify the Commissioner in writing of any change of personnel among its directors or principal officers.”

The Company put into effect procedures beginning with August 2004 to seek to ensure that all changes is reported promptly.

It is recommended that the Company report all changes in directors and principal officers to the Delaware Insurance Department as required by 18 Del.C. §4919.

Conflicts of Interest

The Company maintains a formal written conflict of interest policy statement that has been approved by the Board of Directors. Signed conflict of interest statements of both Directors and Senior Officers have been traced to the Jurat page of the Annual Statement for all years examined.

Bylaws

A review of the Company's bylaws revealed that no changes were made during the examination period.

Corporate Records

The Company's corporate records were reviewed for the period under examination.

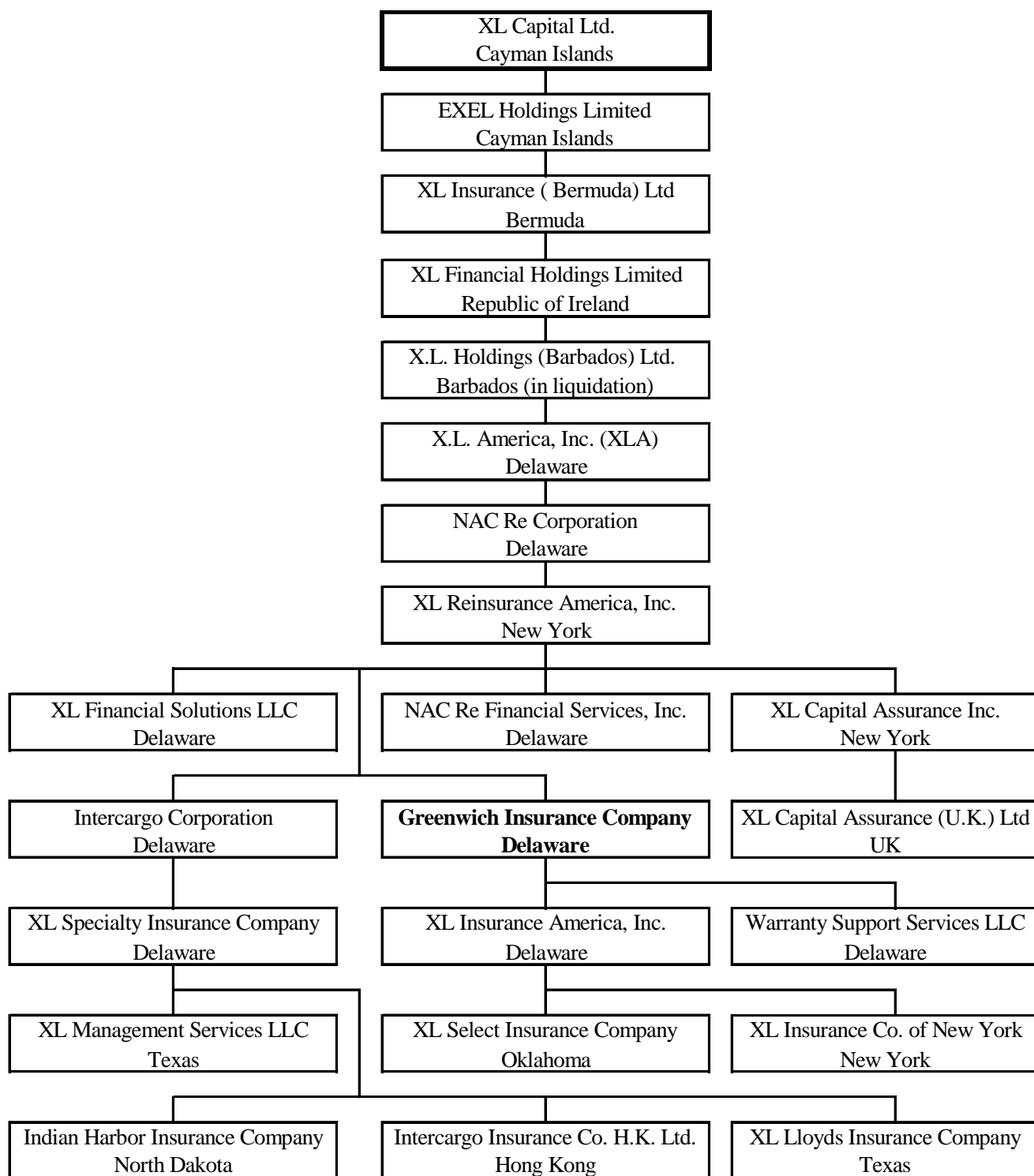
HOLDING COMPANY SYSTEM

The Company is a member of an insurance holding company system. X.L. America is the ultimate United States parent of the Company and its insurer and non-insurer affiliates. X.L. America is an indirect wholly-owned subsidiary of XL Capital, a Caymans Islands domiciled New York Stock Exchange publicly traded company. X.L. America and its affiliates are members of the XL Capital Holding Company System. XL Capital, through its principal operating subsidiaries, is a leading

provider of insurance and reinsurance coverages and financial products to industrial, commercial and professional service firms, insurance companies and other enterprises on a worldwide basis.

The Form B Holding Company Registration Statements filed with the Delaware Insurance Department during the period under examination were reviewed. Per this review, it was determined that the Company has complied with provisions of 18 Del. Admin. Code 1801 (Formerly Regulation 13.)

An organizational chart, which reflects the identities and interrelationships between the Company, its direct and indirect parents and all affiliated insurers, as of December 31, 2005, is as follows:



TERRITORY AND PLAN OF OPERATION

Territory

As of December 31, 2005, the Company was licensed to write business in all states including the District of Columbia and Puerto Rico.

Plan of Operation

In 2005, GIC's major product lines were property, marine, general liability, professional liability, workers compensation, automobile, surety and auto warranty, written by the following operating business units ("OBUs"): XL Environmental, XL Programs, XLRA Programs, XL Professional and XL Select Professional.

For 2005, the Company's premium by OBU was as shown in the table below:

Operating Business Unit	Direct Written Premium (pre-intercompany pooling)
XL Environmental	\$178 mm
XL Programs	\$194 mm
XLRA Programs	\$268 mm
XL Professional	\$37 mm
XL Select Professional	\$43 mm
XL Other Business Units	\$39 mm
Total GIC	\$759 mm

XL Environmental provides integrated environmental risk management solutions incorporating insurance, consulting and claims management to environmental and non-environmental businesses and industries worldwide. This OBU offers insurance solutions for the following industries: architects and engineers, chemical facilities, construction, environmental facilities, environmental services, industrial and commercial facilities, public entities, water and wastewater facilities, real estate and transportation. Headquartered in Exton, Pennsylvania, XL Environmental utilizes the services of

approximately 500 employees of X.L. America and its subsidiaries, with regional employees located throughout the United States.

XL Programs and XLRA Programs offer specialized insurance coverages to distinct market segments through program administrators. These programs provide specialty, property & casualty, warranty and intellectual property coverages to various industries, including habitation, real estate, auto and construction. These OBUs specialize in crafting customized coverages for programs with distinctive, and often complex, products. They offer their program administrators value-added marketing and regulatory support, including policy form review, compliance, administration and strategic communications. XL Programs is based in Exton, Pennsylvania and currently manages total insurance premium in excess of \$300M. XLRA Programs is based in Stamford, Connecticut and currently manages total insurance premium in excess of \$200M.

XL Professional and XL Select Professional specialize in professional indemnity, directors and officers liability insurance, employment practices liability, and management liability on both a primary and excess basis. These OBUs are based in Hartford, Connecticut. Their clients are Fortune International 1000 companies. They provide professional liability insurance solutions that minimize risk through tailored products, meticulous service and a focus on long-term partnerships with clients. They bring industry-leading expertise, service, creativity and financial strength to professional liability insurance. The underwriters work closely with on-staff experts. These experts are familiar with economic, legal and other trends in the industries they serve. This high degree of specialization means that they can tailor programs to customer needs. The philosophy of these OBUs' operations centers on responsiveness, innovative coverage and fair, efficient claims handling. They have among the highest

service standards in the industry, including standards for quote turnaround time, policy issuance, claims resolution and access to staff.

Best's Rating:

Based on AM Best's current opinion of the consolidated financial strength of the members of X.L. America Group, which operates under a business pooling arrangement, each pool member is assigned a Best Rating of A+ (Superior). The Company is assigned the Financial Category of Class XV, which is the Financial Size Category of the Pool, (\$2 billion).

GROWTH OF THE COMPANY

The following information was extracted from copies of the Company's filed Annual Statements with the Delaware Insurance Department for each year indicated:

<u>Year</u>	<u>Net Admitted Assets</u>	<u>Surplus as Regards to Policyholders</u>	<u>Change in Capital and Surplus</u>	<u>Gross Premiums Written</u>	<u>Net Premiums Earned</u>	<u>Net Income</u>
2005	\$728,255,834	\$303,157,055	3.59%	\$886,934,000	\$93,881,197	\$672,683
2004	674,629,622	292,663,501	7.17%	918,064,000	94,076,900	12,385,609
2003	610,028,714	273,078,112	369.7%	914,374,000	75,343,100	(30,638,435)

The Company has experienced mixed results and large variances during the period under examination. The Company incurred growth in assets and surplus, but declined in premium. Net income has not been consistent. Based on the table above, the following took place:

- A 19% increase in admitted assets.
- A 11% increase in surplus as regards to policyholders.
- A 4% decrease in gross written premium.

GIC is a member of the XL Reinsurance America Intercompany Reinsurance Pooling Agreement (the “Pooling Agreement”). Under the terms of the Pooling Agreement, GIC and the other affiliated pool members cede 100% of their gross premiums, claims, insurance expenses and other related underwriting activity to the pool leader, XLRA. XLRA cedes 75% of the pool business, net of specific reinsurance, to its affiliate XL Re Ltd. The remaining 25% of the business is redistributed among the pool members ratable to their surplus. GIC's current share of the redistribution is 12%.

Over the course of the exam period, earnings were negatively impacted by the adverse development in casualty lines of reinsurance business acquired in 1999 through the NAC Reinsurance Corporation merger. Management strengthened reserves for accident years 1997 and 1998 following the completion of the transaction, primarily in commercial auto and other liabilities lines of business. Casualty reserves, however, continued to develop adversely for the next several years, requiring strengthening adjustments in each following calendar year. The strengthening culminated in a charge of approximately \$900 million in 2003. The 2003 charge was based on the conclusion of an extensive claims review conducted in conjunction with outside actuaries, auditors and claims specialists covering cedants of former NAC Reinsurance Corporation's casualty business for accident years 1997 to 2001. The group has expanded rapidly into select insurance lines of business to take advantage of improved market conditions. The expansion emphasizes lines with price adequacy and underwriting discipline.

Historically the Company's investment income has been consistent, although below the industry average. This is reflective of its conservative investment strategies and philosophies of building long-term value. The group's investment yield has fluctuated over the years in response to some variability in the interest rate environment. The average yield has been supported by the strong growth in invested

assets driven by earnings and capital contributions. In previous years, investment income was also aided by the termination of several retrocessional programs and the proceeds subsequently invested. In addition, the group focused on asset/liability matching to mitigate the impact of interest rate fluctuations. In recent years, management has steadily increased its holdings in tax-exempt securities to optimize after-tax investment returns. Net investment income has varied in recent years due to lower interest rates.

Following is a reconciliation of capital and surplus for the period under examination:

Capital and Surplus, December 31, 2002		\$58,137,908
Net income	\$(30,638,435)	
Net unrealized capital gains or (losses)	(33,604,154)	
Change in net deferred income tax	10,880,864	
Change in non-admitted assets	(11,872,485)	
Change in provision for reinsurance	2,631,651	
Capital Changes: Paid In	277,596,844	
Aggregate W/I for gains and losses in surplus	(54,081)	
		<u>214,940,204</u>
Capital and Surplus, December 31, 2003		\$273,078,112
Net income	\$12,385,609	
Net unrealized capital gains or (losses)	16,464,495	
Change in net deferred income tax	(1,094,612)	
Change in non-admitted assets	2,274,390	
Change in provision for reinsurance	(10,441,057)	
Aggregate W/I for gains and losses in surplus	(3,436)	
		<u>19,585,389</u>
Capital and Surplus, December 31, 2004		\$292,663,501
Net income	\$672,683	
Net unrealized capital gains or (losses)	7,008,668	
Change in net unrealized foreign exchange	(155,635)	
Change in net deferred income tax	8,010,633	
Change in non-admitted assets	(5,396,645)	
Change in provision for reinsurance	367,442	
Aggregate W/I for gains and losses in surplus	(13,592)	
		<u>10,493,554</u>
Capital and Surplus, December 31, 2005*		<u>\$303,157,055</u>

*(Not including current examination adjustments)

NAIC RATIOS

The Company's NAIC IRIS Ratio tests were available for all years under review. During the examination period, seven (7) IRIS ratios produced "unusual values" in 2003, four (4) IRIS ratios produced "unusual values" in 2004 and only one (1) IRIS ratio produced an "unusual value" in 2005 as defined by the NAIC Examiner Team in each year under review, as shown in the following table:

Year	Ratio	Ratio Description	Usual Range of Values Over/Under	Company's Result
2003	3	Change In Net Writings	33/-33	335
2003	5	Two Year Operating Ratio	100	131
2003	6	Investment Yield	6.5/3	2.1
2003	7	Gross Change in Surplus	50/-10	366
2003	9	Liabilities to Liquid Assets	105	141
2003	11	One Year Reserve Development to PHS	20	92
2003	12	Two Year Reserve Development to PHS	20	265
2004	5	Two Year Operating Ratio	100	107
2004	6	Investment Yield	6.5/3	2.4
2004	9	Liabilities to Liquid Assets	105	115
2004	12	Two Year Reserve Development to PHS	20	110
2005	6	Investment Yield	6.5/3	2.4

Following is a brief description of the underlying circumstances, which produced the "unusual values" in the Company's IRIS Ratios by examination year:

2003

The Company produced seven (7) "unusual values" in 2003. All of the "unusual values" with the exception of ratio 6 (investment yield) can be explained by two events occurring during 2003: the Company received \$277.6 million in paid in contributions; and the Company's percentage participation

in the Pooling Agreement increased from 4% in 2002 to 12% in 2003. The Company's investment yield of 2.1% is below the minimum of 3% set for this ratio. Management has a very conservative investment strategy focused principally on income predictability and asset value stability. Approximately, 100% of the Company's fixed maturity securities have been rated investment grade by the NAIC (a designation of 1 or 2), as well as by Moody's Investor Services, Inc. or Standard & Poor's. The Company has no investments in derivative instruments and does not participate in securities lending, repurchase, or reverse repurchase transactions or insurer investment pools.

2004

The Company produced four (4) "unusual values". Three of those ratios, ratio 5 (two year operating ratio), ratio 9 (liabilities to liquid assets) and ratio 12 (two year reserve development to policyholder surplus) can be explained by the two events occurring in 2003. Again, as in 2003, the Company's investment yield was 2.4%, which was below the minimum of 3% set for this ratio. See the above explanation for the Company's investment philosophy.

2005

The Company produced just one (1) "unusual value" in 2005, which was ratio 6 (investment yield). The Company's investment yield was the same as reported in 2004, 2.4%, while the minimum is 3% set for this ratio. See 2004 for the explanation for this "unusual value".

FIDELITY BOND AND OTHER INSURANCE

The Company is a covered entity under a Financial Institution Bond in the name of XL Capital, the ultimate parent of the Company. The policy provides a single loss limit of \$70,000,000 with a \$1,000,000 retention. The coverage meets the minimum amount of fidelity bond coverage

recommended by the National Association of Insurance Commissioners for the Company and the other named insureds. Other insurance coverage covering the Company appeared adequate.

PENSIONS AND INSURANCE PLANS

The Company has no direct employees. Qualified full-time employees of X.L. America and its subsidiaries are provided with life insurance, accidental death and dismemberment, short and long-term disability, dental and vision benefits, and comprehensive medical expense benefits.

X.L. America (sponsor and plan administrator) offers a 401(k) employee savings plan that allows employees to contribute up to 15% of salary annually. The sponsor will contribute up to 140% matching on up to the first 5% of employee contributions. The sponsor may also make additional discretionary contributions depending on profitability. The matching benefits are vested ratably over 4 years. Forfeitures are used to defray the plan expenses and then plan contributions.

REINSURANCE

During the examination period, January 1, 2003 through December 31, 2005, the Company was a participant in the Pooling Agreement. Under the terms of the Pooling Agreement, the Company and the other affiliated pool members cede 100% of their gross premiums, claims, insurance expenses and other related underwriting activity to the pool leader, XLRA. XLRA cedes 75% of the pool business, net of specific reinsurance, to its affiliate, XL Re Ltd. The remaining 25% of the business is redistributed among the pool members ratable to their surplus. Pool membership and participation during the examination period was as follows:

<u>Company</u>	<u>12/31/2002</u>	<u>12/31/2005</u>
XL Reinsurance America, Inc.	76%	65%
Greenwich Insurance Company	4%	12%
XL Insurance America, Inc.	8%	10%
XL Select Insurance Company	2%	2%
XL Insurance Company of NY, Inc.	2%	3%
XL Specialty Insurance Company	6%	6%
Indian Harbor Insurance Company	<u>2%</u>	<u>2%</u>
TOTAL	<u>100%</u>	<u>100%</u>

The Pool Agreement in place at December 31, 2005 was approved by the Delaware Insurance Department effective December 31, 2002.

The following discrepancy was noted in review of LOCs and their effect on the provision for reinsurance:

- Reinsurance recoverables for all XL pool members are reported in XLRA's Schedule F, in accordance with the Pooling Agreement. In the case of the AAU voluntary pool, to which XLRA'S affiliate GIC is a member, ceded reinsurance contracts for AAU accounts name Associated Aviation Underwriters or Associated Aerospace Underwriters as the named reinsured. LOC's securing loss recoverable due from unauthorized reinsurers of the AAU pool similarly name Associated Aviation Underwriters or Associated Aviation Underwriters, Inc. (pool manager) as the beneficiary.

XLRA reported total reinsurance recoverables for authorized and unauthorized AAU reinsurers of \$121,598,106 in its 2005 Annual Statement Schedule F, Part 3. No provision for reinsurance for the AAU account was included in its 2005 Annual Statement since it considered all authorized balances to be current and unauthorized balances to be covered by LOC's. Re-calculation of the aging of paid recoverables determined that 100% of the balance was over 90

days old. This, along with the determination by the NY DOI that since LOC's did not name XLRA as the beneficiary, but instead named Associated Aviation Underwriters or Associated Aviation Underwriters, Inc. (pool manager), they did not meet the requirements of NY Reg. 133. The failure to name XLRA as the beneficiary on LOC's issued by AAU pool reinsurers was recognized by the Company as an error during the 2002 examination, with comments noting its intention to correct the error. This was not done.

Recalculation of the provision for reinsurance for AAU accounts, taking these factors into account, resulted in an addition to the provision. This recalculation included provisions for overdue authorized reinsurance and unsecured unauthorized balances.

A proposed adjustment to surplus for the recalculated amount noted above is recommended for examination purposes, to correct the lack of a provision in the 2005 Annual Statement.

It is recommended that the company comply with NAIC Annual Statement Instructions for Schedule F, Part 4 and age its paid loss recoverables in accordance with those instructions.

In addition to the ceded and assumed arrangement of the Pooling Agreement, the Company assumed business from non-affiliates. The following indicates the reinsurance assumed from non-affiliates during each year of the examination period:

2005	\$32,399,720
2004	25,922,383
2003	<u>16,505,555</u>
TOTAL	<u>\$74,827,658</u>

INTERCOMPANY AGREEMENTS

The Company had the following intercompany agreements in effect as of December 31, 2005:

Consolidated Income Tax Allocation Agreement

Fifth Amended Tax Sharing and Payment Agreement

The Company along with other members of the X.L. America Group files a consolidated federal income tax return pursuant to the terms of a tax allocation agreement, effective September 1, 2000, and as amended April 1, 2001, July 1, 2001, January 1, 2003 and April 1, 2004. The members of the group agree to pay an amount equal to the federal income tax liability which such member would have incurred if such member had filed a separate federal income tax return.

For each estimated tax period of any year, the estimated federal income tax liability of each member shall be determined and shall be paid within 10 days of receipt of notice. The final amount required to be paid for any taxable year shall be paid on or before the date on which the consolidated return of the group is required to be filed determined without regard to any extension of time to file.

The examiners noted that pro-forma stand alone tax liability for 2005 was settled with X.L. America on December 12, 2006. Section 4.2 of the Fifth Amended Tax Sharing and Payment Agreement ("Agreement"). states that "payments shall be made each year on or before the date on which the Consolidated Return of the Affiliated Group is required to be filed without regard to any extension of time that may be required for the filing of any Consolidated Return." This settlement is not in accordance with the settlement terms as specified in the Agreement.

It is recommended that the Company settle tax balances in accordance with the Company's Amended Tax Sharing and Payment Agreement.

Consolidated Services Agreement

Amended and Restated General Services Agreement

The Company entered into a General Services Agreement effective January 1, 2003, with X.L. Global Services, Inc. ("XLGS"), X.L. America and various affiliates that calls for XLGS to provide information and technology services, planning, expense management and budget support, project management and application development support, reinsurance services, actuarial services, human resource services and other services. The services are to be charged on a cost basis. A report covering all the items and incurred charges and/or credits will be furnished quarterly with the final payment being remitted within thirty days upon receipt of the quarterly report.

Second Amended General Services Agreement

Effective January 1, 2003, the Company entered into a General Services Agreement with X.L. America, XLRA, and various affiliates. A summary of the agreement follows:

- X.L. America shall perform certain management services including but not limited to the payment of expenses for advertising, boards, bureaus and associations, surveys and underwriting expenses, professional fees, total employee compensation, travel and related expenses, rent and rent items, equipment, printing and stationery, postage, telephone and telegraph, legal and auditing, license fees and taxes, actuarial and accounting, administrative and managerial, data processing, claims, regulatory compliance and miscellaneous items. Also, the subsidiaries that pay or perform services which benefit other subsidiaries are allowed to charge the entities benefiting from those payments or services for the proportionate share of the

costs associated with the payment or service provided. Such services are to be provided on a cost basis.

- A report covering all the items and incurred charges and/or credits will be furnished quarterly with the final payment being remitted within thirty days upon receipt of such quarterly report. In no event shall the cost charged be greater than the subsidiaries would expend in providing such services for themselves.

As part of the examiner's expense review, a copy of the reports for 2005 was requested. The Company indicated that no such reports existed, and that the detail of actual charges could not be ascertained because of the way intercompany expenses are pooled. Charges are determined based on allocations of overhead amounts incurred from X.L. America and XLGS. These amounts are then allocated to XLRA for reinsurance-related expenses and GIC for insurance-related expenses. The insurance-related expenses are then allocated to each legal entity according to the provisions of the Pooling Agreement.

The Company has balances with several of its affiliates which were not settled in accordance with the Service Agreements. The Agreements call for settlement within 30 days after receipt of the quarterly report. The Company's procedural documentation states that settlement of the intercompany balances should occur within 90 days after quarter end. At 12/31/05, the Company did not have a comprehensive procedure in place that required the settlement of all intercompany balances in a timely manner. In November of 2006, the Company issued procedures to cover source balance settlements and regional intercompany settlements. The Company is currently working on identifying old

intercompany balances and reconciling them before the implementation of the new general ledger process in 2008. The Company has initiated a global task force to address the issue as intercompany transactions may also be effected by the foreign currency transactions. It was also noted during the review of the intercompany balances that charges were being made by XL Capital to the pool companies for stock related compensation. XL Capital is not a party to the Service Agreements.

It is again recommended that the Company implement comprehensive procedures to ensure that all intercompany balances are settled in accordance with the service agreements.

It is recommended that the Company develop the ability to age the intercompany items in the new general ledger and that any old intercompany balances be settled prior to the implementation of the new ledger so that initial balances in the new ledger are fully supportable.

EXTERNAL AGREEMENTS

In addition to the above intercompany agreements, the Company had the following external agreement in effect at December 31, 2005:

Investment Custody Agreement

The Company has been party to a Custody Agreement with Mellon Bank since July 30, 2003. Examiners reviewed the SAS 70 Report completed by KPMG LLP on Mellon Global Securities Services as of December 31, 2005. It appears that the custodian has internal controls in place to safeguard the Company's assets and is financially stable. The Company's Custody Agreement is in compliance with the provisions as set forth in Part 1, Section IV, J of the *NAIC Financial Condition Examiner's Handbook*.

LEGAL ACTIONS

The Company is a party to various litigation and claims, common to its business. Management believes that the outcome of such matters will not have a material adverse impact on the financial position or results of operations of the Company. In accordance with *NAIC Annual Statement Instructions*, the Company has made adequate disclosure of its material contingent liabilities where required.

ACCOUNTS AND RECORDS

Accounting System

The Company reports all financial accounting transactions using the PeopleSoft General Ledger application. Statutory financial statements are prepared utilizing the Freedom software application. Enterprise Portfolio System (“EPS”) is utilized for the Company’s investments. The Company additionally utilizes WINS, Genius and Phoenix as its primary commercial insurance processing systems for US business. Functions include policy and claim administration. These systems also serve as source systems for policy production, financial reporting, and statistical reporting. Systems for reinsurance accounting include Destiny and RSG. Standardized insurance accounting procedures are employed in transactions involving premiums, losses, expenses and valuation of assets and liabilities resulting from the operation of the Company.

During the course of the review of the Company’s accounts and records, the operational and organizational controls in place were analyzed. In general, it appears the Company has a sufficient level of controls in place.

However, the following record keeping deficiencies were noted during the course of the current examination:

- The Company was unable to provide detail supporting certain accruals at year end 2005.
 - 1.) Taxes, Licenses and Fees
 - 2.) Bank fee accruals.

It is recommended that the Company maintain adequate records to support account balances recorded in the general ledger.

- It has been determined by management the XLIA OBU Global Risk has been incorrectly posting cash receipts and disbursements to Advance Premiums and instead should have been posting to Remittances and Items not Allocated.

It is recommended that the Company follow NAIC Annual Statement Instructions when completing both their quarterly and annual statements.

- The XL Group incorrectly posted advanced premiums. XL Global Risk and XL Programs OBUs record premium with effective dates after year end as written premium and offset by unearned premium for the same amount. SSAP #53, Paragraph 13 states: Advanced premiums result when the policies have been processed and the premium paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statements and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve.

It is recommended that the Company comply with SSAP #53, Paragraph #13 when recording advanced premiums.

- The Company was incorrectly not carrying any UPR on “run-off” policies. The Company responded that by using underwriting and actuarial pricing assumption, a six year earnings pattern (most policies are issued for a period of six years), it will earn premiums 90% in the first year, 6% in year 2, and 1% in years 3-6. This treatment is consistent with the guidance in SSAP No. 53, paragraph 6, Primary Casualty Contracts. The actuarial firm of INS Consultants agrees with the Company's assertion that 90% of premium will be earned in the first year, 6% in the second year and 1% in years 3-6.

It is recommended that the Company comply with the recommended procedures contained within the NAIC's Accounting Practices and Procedures Manual, SSAP #53, Paragraph 6 when calculating the Company's unearned premium reserve on "run-off" policies.

- As a part of the early close process, it was noted that the Company uses various cut-off dates to recognize written premium from its OBUs. Although the Company uses the cutoff dates to recognize written premium, the Company used the December 31, 2005 date in calculating Unearned Premium Reserve. This accounting underestimates the Company's year-end UPR per annual statement reporting purposes. SSAP 53, paragraph 5 states; “written premiums for all other written contracts, excluding workers' compensation contracts, shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, unearned premium reserve shall be established to reflect the amount of premium for the portion of the insurance coverage that has not expired.”

It is recommended that the Company set up estimated accruals for both written premium and Unearned Premium Reserve that represent written premium and UPR from the cutoff dates to year-end.

- The Company did not accrue for the Profit Sharing Commission payable to Heartland Crop for the Crop Hail and MPCCI business written in 2005.

It is recommended that changes in contract terms be communicated timely to the accounting department so that the appropriate accounting entries can be made.

- XLRA was not able to provide valid support for general ledger account #208723 - Ceded profit commission (debit balance).

It is recommended that the Company maintain adequate records to support account balances recorded in the general ledger.

- The Company as of December 31, 2005 does not have an operational system in place to capture information needed to correctly track and report escheatable property to the various states.

It is recommended that the Company comply with the various state laws regarding escheatable property.

- The Company needs to clear negative deductible balances including issuing a refund to the claimant if it is found that the Company received deductible payments in excess of the recoverable and non-admit balances greater than 90 days past due.

It is recommended that the Company research and clear the negative deductible balances including issuing a refund to the claimant if it is found that the Company has received deductible payments in excess of the recoverable.

It is also recommended that the Company comply with SSAP 65, paragraph 37 and non-admit deductible recoverable balances over 90 days past their contractual due date or billing date if no contractual date has been established.

- The Company failed to book a 90 day overdue balance for the XL Specie OBU at December 31, 2005. The agents' balance for the Vianet program in the XL Programs OBU should have been non-admitted due to the fact that balances related to the Vianet program are difficult to age and that there has been historically, a lack of policy level detail received from Vianet.

It is recommended that the Company ensure that they post all non-admitted premium receivable balances in accordance with SSAP 6.

- The Company paid XLGS \$24,000,000 (\$2 million on 1/30, \$5 million on 2/2, \$5 million on 2/13, and \$12 million on 3/13) to settle its \$13,005,336 December balance with XLGS. The difference of \$10,994,664 was applied as an advance payment to the 1st quarter of 2006. As these amounts were not due to XLGS under the Service Agreement until billed, these overpayments would appear to constitute intercompany loans.

It is recommended that all intercompany settlements/payments be made based upon a written statement reflecting the calculation of the amount of the payment being made.

- The examiners requested the Company's worksheets, at the contract level, which compares the accrued retrospective premium receivable balance to the applicable offsets. The Company responded that they did not perform the calculation but will do so in 2006 and future years.

It is recommended that the Company perform a calculation each year to determine if any accrued retrospective premiums should be non-admitted per the requirements of SSAP 66, paragraph 9.

- During the examination, the Company notified the examiners of the over-cession of losses from XLRA to XL Re Ltd. of \$90,257,803 in reserves, that was associated with the 2003 accident year. The over-cession pertained to a 75% Quota Share Agreement in effect between XL Re Ltd. and XLRA on behalf of itself and its pool members.

It is recommended that the Company take steps to implement controls to ensure future cessions are allocated correctly and that future financial statements are completed correctly and in compliance with NAIC Annual Statement Instructions.

- Review of XL Group Internal Audit Department reports noted a finding relating to re-allocation of ceded IBNR. This finding described a company practice of re-allocating the portion of ceded IBNR attributable to insolvent reinsurers, to solvent reinsurers, thereby taking credit in Schedule F for IBNR recoverables due from insolvent reinsurers. The recognition of reinsurance recoverable assets or recoverable of liabilities due from insolvent reinsurers is

contrary to the requirements of SSAP #62, paragraphs 17-20 and does not meet the test for admitted assets as defined in SSAP #4.

It is recommended that the Company comply with SSAP #62, paragraphs 17-20 by not taking credit in Schedule F for ceded recoverables due from insolvent reinsurers.

- The loss reserves carried by the XL pool members at 12/31/05 show a subsequent year development deficiency of \$32,325,000 at 12/31/06 per New York Department of Insurance's actuary.

It is recommended that the Company use a more conservative approach when calculating their loss reserves.

Independent Accountants

The Company's financial statements are audited each year by the firm of PriceWaterhouseCoopers, LLP ("PwC") of New York, NY. The examiners reviewed the audited statutory financial statements for all years under review and noted that PwC issued an unqualified opinion each year. The work papers of this firm were made available to the examiners and were used to the extent deemed appropriate for this examination.

Actuarial Opinion

The NY Department of Insurance contracted INS Consultants, Inc. ("INS") to review the Actuarial Report issued by Tillinghast for the X.L. America Group. INS reviewed Tillinghast's reconciliations presented in the Actuarial Report by OBU to affirm that the data was appropriately

reconciled at the OBU level. Since OBUs do not align with individual Schedule P lines, INS could not perform independent verifications of this data; however, INS accepted each of the reconciliations performed by Tillinghast at this detailed level.

INS reviewed the reconciliation of the total reserving data to the totals from Schedule P, as presented in the Actuarial Report for the X.L. America Group. INS found that the paid loss data and the case reserves matched to corresponding Schedule P data to within 0.5%, both gross and net.

The review stated that the reserves and related actuarial values carried on the balance sheet are fairly stated and met the requirements of the insurance laws of the State of Delaware.

FINANCIAL STATEMENTS

The following pages contain a statement of assets, liabilities, surplus and other funds as of December 31, 2005, as determined by this examination, along with supporting exhibits as detailed below:

Analysis of Assets, December 31, 2005

Statement of Liabilities, Surplus and Other Funds, December 31, 2005

Statement of Income, December 31, 2005

Schedule of Examination Adjustments

It should be noted that the various schedules and exhibits may not add to the totals shown due to rounding. The narratives on the individual accounts, with the exception of the reserve related balances, are presented on an “exception basis” in the Notes to the Financial Statements section of this report.

Analysis of Assets
As of December 31, 2005

	Assets	Assets Not Admitted	Net Admitted Assets	Note
Bonds	\$332,766,122	\$0	\$332,766,122	
Stocks:				
Common	172,390,492	0	172,390,492	
Cash and short-term investments	68,025,622	0	68,025,622	
Other invested assets	358,187	0	358,187	
Interest, dividends and real estate income due and accrued	3,025,117	0	3,025,117	
Agents' balance				
Premiums in course of collection	28,803,697	7,346,080	21,457,617	1
Deferred premiums, agents' balances and installments booked	52,493,459	0	52,493,459	
Accrued retrospective premium	800,548	80,054	720,494	3
Amounts recoverable from reinsurers		(9,867,482)	9,867,482	2
Funds held by or deposited with reinsured companies	29,299,695	0	29,299,695	
Net deferred tax asset	23,367,711	13,674,056	9,693,655	
Guarantee funds receivable or on deposit	978,527	0	978,527	
Receivable from parent, subsidiaries and affiliates	25,118,637	0	25,118,637	
Funds held or deposited-direct business	8,062,796	0	8,062,796	
Deductible recoverable	689,949	347,794	342,155	4
Receivable from Federal Crop Insurance Corporation	2,587,024	0	2,587,024	
Prepayments	334,890	334,890	0	
	<u> </u>	<u> </u>	<u> </u>	
Total Assets	<u>\$749,102,473</u>	<u>\$11,915,392</u>	<u>\$737,187,081</u>	

Liabilities, Surplus and Other Funds

As of December 31, 2005

		<u>Note</u>
Losses	\$273,446,582	2,10,11
Reinsurance payable on paid losses	4,592,793	
Loss adjustment expenses	19,509,025	
Contingent commissions	3,016,895	5,6
Other expenses	9,137,195	
Taxes, licenses and fees	3,305,031	
Current federal income taxes	10,195,659	
Unearned premiums	49,639,457	7
Advance premiums	12,293,947	
Amounts withheld or retained by company for account of others	603,749	
Remittances and items not allocated	(19,695,073)	
Provision for reinsurance	21,560,154	8
Payable to parent, subsidiaries, and affiliates	35,124,704	
Payable for securities	21,997,201	
Accounts Payable	225,060	9
Contingent Reserve	72,493	
Premium Deficiency	491,915	
Payable on Paid Losses	620,082	
Deferred Commission Revenue	13,982,705	
Funds Held Deposited	<u>557,600</u>	
Total Liabilities	<u>\$460,677,174</u>	
Common capital stock	\$3,558,100	
Gross paid-in and contributed surplus	346,512,697	
Unassigned funds (surplus)	<u>(73,560,890)</u>	
Surplus as regards policyholders	<u>\$276,509,907</u>	
Total liabilities and surplus	<u><u>\$737,187,081</u></u>	

Underwriting and Investment Exhibit
Statement of Income
Capital & Surplus
As of December 31, 2005

UNDERWRITING INCOME

Premiums earned	\$93,881,197
DEDUCTIONS:	
Losses incurred	\$70,976,429
Loss expenses incurred	11,973,389
Other underwriting expenses incurred	15,465,731
Aggregate write-ins for underwriting deductions	491,915
Total underwriting deductions	\$98,907,464
Net underwriting gain or (loss)	(\$5,026,267)

INVESTMENT INCOME

Net investment income earned	\$12,322,877
Net realized capital gains or (losses)	(272,817)
Net investment gain or (loss)	\$12,050,060

OTHER INCOME

Net gain or (loss) from agents' or premium balances charged off	\$213,654
Aggregate write-ins for miscellaneous income	2,267,019
Total other income	\$2,480,673

Net income before dividends to policyholders and before federal income taxes	\$9,504,466
Dividends to policyholders	0
Net income after dividends to policyholder but before federal income taxes	\$9,504,466
Federal and foreign income taxes incurred	(8,831,783)
NET INCOME	\$672,683

CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2004	\$292,663,501
GAINS AND (LOSSES) IN SURPLUS	
Net income	\$672,683
Net unrealized capital gains or (losses)	7,008,668
Change in net unrealized foreign exchange capital loss	(155,635)
Change in net deferred income tax	8,010,633
Change in non-admitted assets	(5,396,645)
Change in provision for reinsurance	367,442
Aggregate write-ins for gains and losses in surplus	(13,592)
Change in surplus as regards policyholders for the year	\$10,493,554
Adjustment to surplus as a result of 12/31/05 Examination	(\$26,647,148)
Surplus as regards policyholder, December 31, 2005	<u>\$276,509,907</u>

Schedule of Examination Adjustments

As of December 31, 2005

<u>Description</u>	<u>Per Examination</u>	<u>Per Company</u>	<u>Surplus Increase (Decrease)</u>	<u>Note</u>
Assets:				
Agents' balances	\$21,457,617	\$22,004,857	(\$547,240)	1
Reinsurance recoverables on loss and LAE	9,867,482	0	9,867,482	2
Accrued retrospective premiums	720,494	800,548	(80,054)	3
Deductible Recoverable	<u>342,155</u>	<u>651,096</u>	<u>(308,941)</u>	4
Adjusted Admitted Assets	<u>\$32,387,748</u>	<u>\$23,456,501</u>	<u>\$8,931,247</u>	
Liabilities and Surplus:				
Loss and LAE	(\$292,955,607)	(\$265,754,703)	(\$27,200,904)	2,10, 11
Commission payable	(3,016,895)	(2,572,083)	(444,812)	5,6
Unearned premiums	(49,639,457)	(49,326,127)	(313,330)	7
Provision for reinsurance	(21,560,154)	(14,069,415)	(7,490,739)	8
Accounts Payable	(225,060)	(96,450)	(128,610)	9
Unassigned Funds (Surplus)	<u>73,560,890</u>	<u>46,913,742</u>	<u>26,647,148</u>	
Adjusted Liabilities and Surplus	<u>(\$293,836,283)</u>	<u>(\$284,905,036)</u>	<u>(\$8,931,247)</u>	

NOTES TO FINANCIAL STATEMENTS

Assets

(1) Agents Balances: \$21,457,617

The above-captioned amount, reflects adjustments decreasing the balance reported by the Company for \$547,240 for over 90 day balances for the XL Specie OBU and the Vianet program premiums.

GIC 12% of \$4,560,336 = \$547,240

(2) Reinsurance Recoverable: \$9,867,482

The above captioned amount reflects an adjustment increasing this account by \$9,867,482. During the course of the examination, XLRA discovered and reported that it had overceded a total of \$90,257,803 in reserves that was associated with the 2003 accident year, to XL Re Ltd., an affiliate. The over-cession pertained to a 75% Quota Share Agreement in effect between XL Re Ltd. and XLRA on behalf of itself and its pool members. Because of the over-cession, the Pool needed to make the following adjustments to correct its financial statements in the 3rd quarter, 2006:

	DR	CR
Reinsurance Recoverables	\$82,229,016	
Case Reserves	39,108,674	
Surplus	90,257,803	
IBNR Reserves		\$211,595,493

The Allocation to GIC as a member of the Pool is as follows:

Losses

GIC 12% of \$172,486,819 = 20,698,418

Reinsurance Recoverable

GIC 12% of \$82,229,016 = 9,867,482

(3) Accrued Retrospective Premiums:

\$720,494

The above captioned amount reflects an adjustment decreasing the Company reported balance by \$80,054. The examination requested the Company's worksheets, at the contract level, which compares the accrued retrospective premium receivable balance to the applicable offsets. The Company responded that they did not perform the calculation. The examination had no documentation to determine if there were any excess over offsets. The examination assumed that there were no offsets and non-admitted 10% of the reported balance (\$6,671,231 X 10%) to comply with the requirements of SSAP 66, paragraph 9. The adjustment to GIC as a member of the Pool is 12% of \$667,123 or \$80,054.

(4) Deductible Recoverable

\$ 342,155

The above captioned amount reflects an adjustment decreasing this asset by \$308,941. The examiner noted that the Company had balances in Genius of \$2,496,493 and in GAIN of \$195,463.79 which were over 90 days past due. These amounts should be non-admitted for examination purposes in accordance with SSAP 65, paragraph 37 which states that "Deductible recoverables that are greater than ninety days old shall be non-admitted." After application of cash received that was not processed against these balances of \$117,447, the non-admitted portion is \$2,574,510 for the Pool. The adjustment to GIC as a member of the Pool is \$2,574,510 X 12% or \$308,941.

Liabilities

(2) Losses: (\$266,944,096)Loss Adjustment Expenses: (\$19,509,025)

The above captioned amount on a combined basis is \$20,698,418 more than that reported by the Company in its 2005 Annual Statement. During the course of the examination, the Company notified the examiners of the over-cession of losses from XLRA to XL Re Ltd. As a result, the Delaware Insurance Department retained the services of a consulting actuary to conduct an independent review of the Company's loss and loss adjustment expense reserves as of December 31, 2005. Note that the above adjustment to "Losses" is a result of XLRA overceding a total of \$90,257,803 in reserves that were associated with the 2003 accident year. The over-cession pertained to a 75% Quota Share Agreement in effect between XL Re Ltd. and XLRA on behalf of itself and its pool members. Because of the over-cession, the Pool needed to make the following adjustments to correct its financial statements in the 3rd qtr, 2006:

	DR	CR
Reinsurance Recoverables	\$82,229,016	
Case Reserves	39,108,674	
Surplus	90,257,803	
IBNR Reserves		\$211,595,493

The allocation to GIC as a member of the Pool is as follows:

<u>Losses</u>	<u>Reinsurance Recoverable</u>
GIC 12% of \$172,486,819 = 20,698,418	GIC 12% of \$82,229,016 = 9,867,482

(5,6) Commissions Payable

\$3,016,895

The above captioned amount reflects two adjustments to increase this liability account by \$444,812. The first adjustment was a result from the Pool failing to accrue for the Profit Sharing Commission payable to Heartland Crop for the Crop Hail and MPC I business written in 2005. Heartland Crop had a 45% profit sharing commission on the business. The estimated liability for the profit sharing commission due on 2005 business was \$11,180,443. This amount was subject to an 85% crop hail quota share retrocession and to the 75% Quota Share Agreement with XL Re, Ltd. The amount of the adjustment to the Pool was \$419,267.

The adjusting entry for the entire pool was:

	<u>Debit</u>	<u>Credit</u>
Surplus	\$ 419,267	
Commissions Payable		\$419,267

The allocation to GIC as a member of the Pool was 12% of the above or \$50,312.

The second adjustment was a result from XLRA's failure to provide valid support for general ledger account #208723 - Ceded profit commission (debit balance) in the amount of \$3,287,498 as of December 31, 2005. The post-pooling adjustment to GIC was 12% of that total or \$394,500.

(7) Unearned Premium

\$49,639,457

The above captioned amount reflects an adjustment increasing this liability by \$313,330. Examiner noted during the sample testing of various lines of business, that the Company

incorrectly calculated UPR for the XL Professional OBU's "Run-Off" Policies. Run-off policies occur when an event changes the original make-up of the company (i.e. acquisition, change of Board members or merger) which causes the original Board of Directors to be left without D&O coverage. The original D&O policy goes into run-off upon the trigger event and the unearned premium is returned to the client. A run-off premium is charged to provide an extended reporting period, normally for 3 to 6 years, for coverage to the Directors for the original policy period up to the date of the event. This is done because the exposure period is in the past, and the policy premium received for the run-off policy is not subject to the return premium process. The run off endorsement states that the premium is fully earned on the date of the event and will not be returned to the client if the endorsement is cancelled. The Company was incorrectly not carrying any UPR on this type of policy.

The Company responded that by using underwriting and actuarial pricing assumption, a six year earnings pattern (most policies are issued for a period of six years), it will earn premiums 90% in the first year, 6% in year 2, and 1% in years 3-6. This treatment is consistent with the guidance in SSAP No. 53, paragraph 6, Primary Casualty Contracts. The actuarial firm of INS Consultants agrees with the Company's assertion that 90% of premium will be earned in the first year, 6% in the second year and 1% in years 3-6. The Company provided a spreadsheet which calculates the UPR based on the earnings curve. This workpaper shows that the Company has a \$10,444,331 difference in what the Company has for UPR on this type of policy and what the recalculated UPR should be based on the earnings curve at December 31, 2005. The \$10,444,331 is subject to the 75% Quota Share Agreement. Therefore, the adjustment is $\$10,444,331 - \$7,833,248 = \$2,611,083$ to the Pool. GIC's portion of the adjustment is 12% of the total or \$313,330.

(8) Provision for Reinsurance

\$21,560,154

The above captioned amount reflects an adjustment of \$7,490,739 increasing this liability. This adjustment was a result of reinsurance recoverables for all Pool members a reported in XLRA's Schedule F, in accordance with the Pooling Agreement. In the case of the AAU voluntary pool, to which GIC is a member, ceded reinsurance contracts for AAU accounts name Associated Aviation Underwriters or Associated Aerospace Underwriters as the named reinsured. LOC's securing loss recoverable due from unauthorized reinsurers of the AAU pool similarly name Associated Aviation Underwriters or Associated Aviation Underwriters, Inc. (pool manager) as the beneficiary.

XLRA reported total reinsurance recoverables for authorized and unauthorized AAU reinsurers of \$121,598,106 in its 2005 Annual Statement Schedule F, Part 3. No provision for reinsurance for the AAU account was included in its 2005 Annual Statement since it considered all authorized balances to be current and unauthorized balances to be covered by LOC's. Re-calculation of the aging of paid recoverables determined that 100% of the balance was over 90 days old. As mentioned above, along with the determination by the NY DOI that since LOC's did not name XLRA as the beneficiary, but instead named Associated Aviation Underwriters or Associated Aviation Underwriters, Inc. (pool manager), they did not meet the requirements of NY Reg. 133. The failure to name XLRA as the beneficiary on LOC's issued by AAU pool reinsurers was recognized by the Company as an error during the 2002 examination, with comments noting its intention to correct the error. This was not done.

Recalculation of the provision for reinsurance for AAU accounts, taking these factors into account, resulted in an addition to the provision of \$62,422,826 for the Pool. This recalculation included provisions for overdue authorized reinsurance and unsecured unauthorized balances.

A proposed adjustment to surplus for the recalculated amount noted above is recommended for examination purposes, to correct the lack of a provision in the 2005 Annual Statement. GIC's portion of this adjustment to surplus is 12% of the total or \$7,490,739.

(9) Accounts Payable

\$225,060

The above captioned amount reflects an adjustment of \$128,610 increasing this liability. XLS did not accrue for services rendered by KPMG at 12/31/05. KPMG was engaged by XLS in 2005 to conduct an audit of claims processing and procedures. The Company paid \$1,071,748 for these services in March 2006. This amount should have been accrued for at 12/31/05. The post pooling adjustment to GIC was 12% of the total or \$128,610.

(10) Losses

\$269,569,582

The above captioned amount reflects an adjustment of \$2,625,486 increasing this liability. Review of XL Group Internal Audit Department reports noted a finding relating to re-allocation of ceded IBNR. This finding described a company practice of re-allocating the portion of ceded IBNR attributable to insolvent reinsurers, to solvent reinsurers, thereby taking credit in Schedule F for IBNR recoverables due from insolvent reinsurers. XL Group re-allocated IBNR totaling \$21,879,055 for the Pool in XLRA's 2005 Annual Statement Schedule F. The recognition of reinsurance recoverable assets or recoverable of liabilities due from insolvent

reinsurers is contrary to the requirements of SSAP #62, paragraphs 17-20 and does not meet the test for admitted assets as defined in SSAP #4. The post pooling adjustment to GIC was 12% of the total or \$2,625,486.

(11) Losses

\$273,446, 582

The loss reserves carried by the XL pool members at 12/31/05 showed a subsequent year development deficiency of \$32,325,000 at 12/31/06, per New York Department of Insurance's actuary. Based on the actuary's development for each Pool Member the adjustment for GIC was \$3,877,000

COMPLIANCE WITH PRIOR REPORT RECOMMENDATIONS

A review was performed of appropriate balance sheet and forepart files to verify corrective action had been taken with regards to prior examination report comments and recommendations.

Management and Control

Board of Directors

1. Prior Exam Comment: It is recommended that the Company report all changes in directors and principal officers to the Delaware Insurance Department as required by 18 Del.C. §4919.

Current Exam Finding: A review of all changes to officers and directors of the Company during the examination period revealed that not all changes had been reported to the Delaware Insurance Department in accordance with 18 Del.C. §4919. Accordingly, the prior report recommendation remains open as of December 31, 2005. It is noted that the Company put into effect procedures to comply with the reporting requirements in 2004. (See current examination recommendation noted in the “Management and Control” section of this Report, under the caption “Officers”)

Territory and Plan of Operation

Managing General Agents

2. Prior Exam Comment: The 2002 examination report contained 14 recommendations relating to the Managing General Agents Act and Agreements. All recommendations were cleared except as follows:

- **It is recommended that the Company comply with 18 Del. C. §1805(a) by obtaining copies of the MGA CPA audit reports. Two out of the three reports reviewed were audited. The third was only a compiled financial statement. REPEAT FINDING.**

- It is recommended that the Company comply with 18 Del. C.§1805(b) by obtaining the opinion of an actuary attesting to the adequacy of the MGAs established loss reserves. The Company does not obtain actuarial opinions. REPEAT FINDING.

SUMMARY OF RECOMMENDATIONS

Management and Control (Page #7)

It is recommended that the Company report all changes in directors and principal officers to the Delaware Insurance Department as required by 18 Del.C. §4919. (See Management and Control: Officers, page.)

Letter of Credit effect on Provision for Reinsurance (Page #19)

It is recommended that the Company comply with NAIC Annual Statement Instructions for Schedule F, Part 4 and age its paid loss recoverables in accordance with those instructions.

Federal Income Tax Intercompany Agreements (Page #20)

It is recommended that the Company settle their intercompany tax balances in accordance with the Company's Amended Tax Sharing and Payment agreement.

Intercompany Balances (Page #23)

It is again recommended that the Company implement comprehensive procedures to ensure that all intercompany balances are settled in accordance with the service agreements.

Aging Intercompany Balances (Page #23)

It is recommended that the Company develop the ability to age the intercompany items in the new general ledger and that any old intercompany balances be settled prior to the implementation of the new ledger so that initial balances in the new ledger are fully supportable.

Taxes, Licenses and Fees (Page #25)

It is recommended that the Company maintain adequate records to support account balances in the general ledger. The Company is in violation of 18 Del.C. § 520(b), (3), which states in part....”or to produce its accounts, records and files for examination by the Commissioner when required”

Reclassification of Advance Premiums (Page #25)

It is recommended that the Company follow NAIC Annual Statement Instructions when completing both its quarterly and annual statements.

Advance Premium (Page #26)

It is recommended that the Company comply with SSAP #53, Paragraph #13 when recording advance premiums.

Unearned Premium Reserve (Page #26)

It is recommended that the Company comply with the recommended procedures contained within the NAIC's Accounting Practices and Procedures Manual, SSAP #53, Para 6 when calculating the Company's unearned premium reserve on "run-off" policies.

Unearned Premium Reserve (Page #27)

It is recommended that the Company set up estimated accruals for both Written Premium and Unearned Premium Reserve that represent written premium and UPR from the cutoff dates to year-end.

Commissions Payable (Page #27)

It is recommended that changes in contract terms be communicated timely to the accounting department so that the appropriate accounting entries can be made.

Ceded Profit Commissions (Page #27)

It is recommended that the Company maintain adequate records to support account balances recorded in the general ledger.

Escheatable Property (Page #27)

It is recommended that the Company comply with the various state laws regarding escheatable property.

Deductible Recoverables (Page #28)

It is recommended that the Company research and clear the negative deductible balances including issuing a refund to the claimant if it is found that the Company has received deductible payments in excess of the recoverable.

It is also recommended that the Company comply with SSAP 65 paragraph 37 and non-admit deductible recoverable balances over 90 days past their contractual due date or billing date if no contractual due date has been established.

Over 90 Day Non-Admitted Receivables (Page #28)

It is recommended that the Company ensure that they post all non-admitted premium receivable balances in compliance with SSAP 6.

Intercompany Loans (Page #29)

It is recommended that all intercompany settlements/payments be made based upon a written statement reflecting the calculation of the amount of the payment being made.

Non-admitted/Offset Calculation (Page #29)

It is recommended that the Company perform a calculation each year to determine if any accrued retrospective premiums should be non-admitted per the requirements of SSAP 66, paragraph 9.

Over Cession of Reserves (Page #29)

It is recommended that the Company ensure future cessions are allocated correctly and ensure that future financial statements are completed correctly in compliance with the NAIC Annual Statement Instructions.

IBNR Re-allocation (Page #30)

It is recommended that the Company comply with SSAP #62, paragraphs 17-20 by not taking credit in Schedule F for ceded recoverables due from insolvent reinsurers

Developmental Deficiency on Loss Reserves (Page #30)

It is recommended that the Company use a more conservative approach when calculating their loss reserves.

Audited Financial Statements - MGAs (Page #45)

It is again recommended that the Company obtain audited financial statements for all of its MGAs.

Actuarial Opinion of MGA Reserves (Page #46)

It is again recommended that the Company comply with its agreements and 18 Del. C. § 1805(b) of the Delaware Insurance Code by annually obtaining the opinion of an actuary attesting to the MGA's adequacy of its established loss reserves for losses incurred and outstanding on business produced by the MGA. This is in addition to any other required loss reserve certification.

CONCLUSION

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

<u>Description</u>	<u>December 31, 2002</u>	<u>December 31, 2005</u>	<u>Increase</u>
Assets	\$342,636,295	\$737,187,081	\$394,550,786
Liabilities	312,944,062	460,677,174	147,733,112
Capital and Surplus	29,692,233	276,509,907	246,817,674

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. is acknowledged.

Respectfully submitted,



Michael A. Davis, CFE
Examiner-In-Charge
State of Delaware
Northeastern Zone, NAIC